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Intereconomics

Suggested Citation: Küng, Emil (1967) : Subsidies to exports in developing countries, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 02, Iss. 11, pp. 295-297,
<https://doi.org/10.1007/BF02930544>

This Version is available at:

<https://hdl.handle.net/10419/137824>

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Subsidies to Exports in Developing Countries

by Professor Dr Emil K  ng, St. Gallen

Both within the framework of the World Trade Conference of 1964 and the United Nations Conference on Trade and Development (UNCTAD) originating from it, the developing countries recommended that they should be authorised to pursue export promotion by subsidising their exports. Sooner or later this idea will have to be discussed, since a number of arguments is favouring it. For the time being, however, GATT (General Agreement on Tariffs and Trade) is obstructing this project as the Agreement disapproves of export subsidisation. That government subsidies to exports create distortions of competition is the reason for this disapproval. The suppliers in the respective countries would be enabled to sell their products at lower prices than others although they may have the same cost prices. The intention was to avoid such distortions as far as possible.

The representatives of developing countries argue with references to justice, while nevertheless they take the view that the standards of GATT should be interpreted in their favour. They set forth that, although it would be advisable to prohibit export subsidies generally if the conditions in the countries involved are more or less similar, in this connexion, however, this be out of the question. For, on the one side, there were the developed and prosperous industrial nations, and, on the other, the poor developing countries. What would be adequate for the former group, need not at all be so for the latter. On the contrary, justice would call for paying attention to the basic difference in prosperity. The industrial nations would be much less dependent on additional export and foreign exchange proceeds than the developing countries.

In fact it cannot be denied that the amount of available foreign currencies is the decisive limitation of the industrialisation process of poor economies. If the foreign exchange proceeds are increasing for some reason or other, additional capital goods may be imported and new jobs created—provided that this capital is not again invested for security reasons in Europe or America. So also the partners in rich countries have to admit that an increasing flow of foreign exchange to the materially backward economies would be desirable.

The Disillusion

Simultaneously, however, they have to admit that development aid being offered in the shape of gifts and capital aid did not grow in recent years but

stagnated more or less. There are certainly reasons for this. They may be found in the fact that the success of measures taken hitherto is quite unsatisfactory and that originally a much better efficiency had been hoped for. This attitude consequently leads to the demand for more self-aid. What, however, would be more suited to demonstrate this self-aid than an intensified exchange of goods with the developed countries, which would give the developing areas the chance of earning the desired additional foreign currency by their own efforts? And would subsidies to exports not comply with this demand?

Moreover, there is another consideration. It is quite obvious that developing countries might obtain higher foreign exchange proceeds if the richer nations would open their markets more than hitherto. But such a reduction of tariffs and quotas—possibly limited to supplies from developing countries—is meeting with considerable difficulties. However, as long as such a reduction cannot be realised, the "poor South" might be offered another opportunity to increasingly join world trade—i.e. by admitting subsidisation of exports.

The General Prejudice

Further arguments may be quoted still to justify this demand. So it is a fact that producers of raw materials and farming products are prejudiced by modern technical developments, that continuously produce new plastics thus replacing traditional raw materials and textile fibres. The raw material demand for a product unit is declining because one is learning how to use these materials more economically. Salvaged materials are increasingly redirected into the circulation of goods and reduce new demand. Foodstuffs profit—if at all—very much below average from economic growth, either because their per capita sales remain more or less unchanged, because the industrial nations adhere to a pronouncedly protectionist policy in favour of their own agriculture, or because the farmers increase vigorously their production in the domestic market in industrialised nations reserved for them.

Simultaneously frequent price fluctuations are a typical feature of conditions in the field of international staple goods and thus also foreign exchange proceeds are very insecure. This of course must render regulated long-term investment activities most difficult. In the case of mono-cultures the producers cannot do much about these fluctuations. No wonder that under such conditions a wider diversification of the range

of products is demanded—even though its realisation would abandon the present specialisation carried through owing to the comparative costs.

Industrialisation a Way-out?

It is quite obviously one of the poor economies' basic problem how to offer jobs to available labour willing to work. In the primary sector of farming this possibility is very limited indeed. Above all the secondary sector of industry comes into question for the solution of this problem. In their difficult initial period industries can be developed by offering them protection in the shape of "educational tariffs" against too powerful foreign competition. Thus in Latin America we find tariffs of 100 or even 200 per cent that are supposed to achieve this purpose. It is their only disadvantage that, as known by experience, they are almost never abolished again, and their protective function becomes a permanent institution. Thus of course they lose their macro-economic right to exist.

Therefore, could and should industrialisation not be promoted some other way? Would it not be more advantageous to promote such sectors of production, that are working for export and thus for this reason alone should be able to compete internationally? Is it not necessary to consider the fact that the population's purchasing power does not yet suffice for some of the industrial manufactures? Is under such conditions the size of an enterprise not depending necessarily on exports? Would it thus not be preferable to employ the available funds for subsidies to exports and not for protective tariffs? Would the misdirection of productive facilities not be smaller with such a solution than with a protectionist one?

The Reverse of the Medal

First we notice that indeed quite important facts are advocating a subsidisation of exports. However, as with most economic policy discussions a detailed analysis is showing that also the opponents do not lack arguments and that a convincing decision on the pros and cons is by no means easy. To begin with one of the most important limitations to the success of the planned procedure is the fact that by no means higher foreign exchange proceeds are to be obtained in all cases, if the sales price of an export product is reduced artificially. In order to illustrate this it is to be assumed that a certain product hitherto has been offered at a price of 100 Francs a piece and that the sales volume has been 100 pieces. The total proceeds thus amounted to 10,000 Francs.

Now the sales price would be reduced by 20 per cent, i.e. to 80 Francs a piece, because the exporting country is granting an export bounty. If the sales volume remains the same, the turnover in terms of value is reduced to 8,000 Francs. In reality, however, the saleable volume should increase. But this increase would have to be quite considerable in order only to compensate the loss caused by the price reduction. This is a question of the so-called price-elasticity of

demand. If this does not surpass a certain minimum, in spite of subsidies the result will not be an increase but possibly even a reduction of the foreign exchange inflow. And even though the export in terms of value should rise, the scale of this reaction is possibly so moderate that the whole effort is almost not profitable at all. For it must not be ignored that of course the required funds have to be raised somehow and that for this purpose the taxpayers of the exporting country have to be soaked.

Prospect of Success

A recapitulation of the developing countries' export products seems to indicate that a high price elasticity of domestic demand for farming products and raw materials is rather improbable. For, if these goods are offered at lower prices, in exceptional cases only many more of them will be bought. The sales chances will rather be influenced mainly by the level of employment in industrial countries and by the number of consumers. The chances are not much better in the case of semi-finished and finished manufactures. Here the less developed countries will mainly produce those staple goods of lower quality that require comparatively small capital expenditure but much manpower. It is these products, however, that frequently belong to the "inferior goods", which in the course of increasing prosperity are gradually replaced by better ones.

Moreover, it has to be pointed out that the general application of export subsidies will show very different results from that case, in which one country alone is using this instrument. If the artificial reduction in prices is limited to one country alone, then it is not impossible that this country will be able to increase its export proceeds—at the expense of others. If, however, all these countries do the same, nothing will be changed and the overall result may be very well rather disappointing.

The Terms of Trade

In this case one thing only is certain, i.e. that the developing countries will hurt themselves. Namely, they sell their products at lower prices than before without creating any inducement for the industrial countries to supply their manufactures, imported by the less developed nations, at lower prices, too. (For the share of raw materials in the final selling price e.g. of investment goods is very negligible.) The result will therefore be that the poor nations deteriorate the terms of trade applying to them—while already now they are complaining how much this "real exchange ratio" has developed to their disadvantage.

Such policies do not seem to be very logical. At best they might be justified somewhat if the volume of sales could be raised to a considerable extent and if in connection with this development much more labour could be integrated into the industrial production process. However, a prerequisite to this success in the field of employment policy are extensive investments—investments for which the correspond-

ing material capital goods in most cases have to be imported first from the industrial countries.

Moreover, care would have to be taken that the developed economies were not allowed to take defensive measures against this officially approved dumping. For otherwise it might happen that the importing countries, in order to defend themselves against this price cutting, would raise compensatory duties reaching the level of this "dumping margin". This is what would happen finally in such a case: The taxpayers in the developing countries would have to carry a heavier tax burden, which indirectly would be to the advantage of the treasuries and taxpayers in rich countries, without any possibility of enforcing additional foreign exchange proceeds. Certainly a paradoxical transfer of purchasing power.

The Alternative of Devaluation

Subsidies are somewhat problematical anyway. In less developed countries, however, the risk of a misuse is particularly great, as these funds might ooze away within the administration, or the receivers might use them for other purposes than had been planned. Therefore it would be preferable if the same

effect could be obtained some other way. This applies to a devaluation, since this device also creates better sales chances for the exporters. Simultaneously it produces another result, i.e. that foreign exchange demand of imports is rather declining. The taxpayers could be spared for the time being. There would be no need of a special administration and thus there would be no risk of corruption. Why not apply this instrument instead of persisting in subsidies to exports?

In fact such a solution of the problem would meet with incomparably smaller obstruction also on the side of the industrial nations. The developing countries' currencies are mostly overvalued rather than underrated. If instead one would change over to "realistic" exchange rates or even to a certain under-valuation, the foreign exchange control measures need not be maintained, as the balance of payments would be squared automatically. These were advancements that the developed economies would welcome heartily. The nightmare of "competitive devaluations", dating from the thirties, has lost its power to alarm in a time of overemployment and inflationary tendencies. Who knows whether or not the devaluation of the Indian Rupee of June, 1966, did not base on such ideas?

JOINING THE COMMON MARKET

Waiting List for Associate Members

by Klaus-Peter Waldberg, Hamburg

Considered superficially, one might almost gain the impression that EEC is like the magician's apprentice who can no longer control the spirits he has invoked. Only too often, in recent years, have complaints about trade policy from our partners in Europe and abroad been answered by referring to the opportunities to be derived from association with the Common Market. Now the applications are multiplying and Brussels will soon have to draw up a waiting list. Such a situation could become very unpleasant because the EEC—and in particular the Council of Ministers—does not appear to have decided on a clear method of procedure.

A Great Number of Applications

Right from the outset, 18 former colonial territories of France, Belgium and Italy in Africa were connected with EEC by means of an Association Agreement. After this has expired—the initial limit was 5 years—this Agreement was replaced by a second one at the request of the states concerned; these had meanwhile gained their independence. Following this pattern, an Association Agreement was concluded with Nigeria a year ago. After long negotiations, Greece and Turkey became associate members in 1964 and 1965 respectively. The last colonial territories of a few EEC countries—Surinam and the Dutch

Antilles, for instance—must also be added to the group of EEC associate members.

The number of candidates who would like to achieve a similar status is very large. Negotiations have been proceeding with Austria for some time. Sweden's, Portugal's and Switzerland's applications for associations have, in practice, been dormant since 1963, but if Britain's request to join is repeated, a renewal of these must also be anticipated. Finland, which has hitherto been associated with EFTA, would probably follow suit. In the past few days the Commission has received a definite mandate which allows it to negotiate in detail with Spain on the latter's desire to become an associate member, presented three years ago. It is also probable that final arrangements will now be made with the Maghreb States—Algeria, Morocco, Tunisia—which have long wished to become associate members. Israel wishes to replace its trade agreement with the EEC by an association agreement. Talks with the three East African countries—Kenya, Tanzania and Uganda—are at present in abeyance, but will certainly be resumed shortly. Only recently, Indonesia was almost granted an association agreement. It was apparently only at the last moment that the delegation which had travelled to Brussels to present Indonesia's application changed its mind about this project.